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# ECONOMIC REVIEW

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## SUITABLE FORMS OF LOCAL TAXATION

### FOREWORD

In present-day Japan, the reform of the tax system with a view to increasing revenue has become one of the important national problems. Such a tax reform has also become inevitable. Moreover, it must be effected in both national and local taxation under the prevailing situation. Nor will it be sufficient merely to increase the rates of the existing taxes without modifying the form of taxation, although the present circumstances definitely point to the necessity of increasing the tax rates after having effected a fundamental adjustment of all existing taxes. This involves an adjustment and re-arrangement of the location of the taxes. National taxes which are more suitable as local taxation must be transferred to local communities, while local taxes which are more suitable as national taxation must be placed under State jurisdiction. Before effecting this tax reform, it is necessary to consider under what conditions local taxation

is appropriate. After this has been made clear, an examination of various taxes should be made in order to see if they fulfil these conditions and so are qualified as local taxes. I shall take up this problem in the present article and express my views regarding the subject under consideration.

### 1. REQUIREMENTS OF LOCAL TAXATION

The requirements of local taxes may be either absolute or relative. The former cover what is absolutely necessary while the latter cover only what is desirable. Absolute requirements, may further, cover both special local taxes and local surtaxes; on the other hand, they may cover only special local taxes but not local surtaxes.

#### (1) *Absolute requirement.*

(A) It is absolutely necessary that the objects of local taxes should be of easy local distribution; in other words, they should be easy of taxation by local authorities. This requirement covers all local taxes whether special taxes or surtaxes, and taxes lacking in this requirement are unsuitable as local taxation. Some of the local taxes at present do not have this requirement and must therefore be reformed. For example, the income tax, the property tax and the household tax — which is merely a varied form of the income and the property taxes — are local taxes, but they are not properly levied because their tax objects, namely, income and property, are unsuitable for local taxation. They are apt to give rise to either double taxation or evasion. The levying of these taxes by local authorities may be made according to some fixed policy, but there is no assurance that such policy will be just. The taxes on transactions and on consumption are also unsuitable as local taxes or for administration by a single locality, inasmuch as the actual transactions and the objects consumed are not limited to a single locality but extend over many localities. Let us explain this by taking, as an example, the excise on *sake*.

*Sake* is principally produced in the Nada district and consumers in Kyoto get their supplies chiefly through merchants in Osaka and Kyoto. Thus, *sake* has relations with these three localities, and it will be difficult equitably to spread the tax on *sake* over these localities. The same thing may be said of commercial bills which are circulated throughout many different localities. But there are objects of taxation which may be easily dealt with by single localities without any hitch or injustice. The most representative of such objects are land and houses. The taxes on land and houses may be said to be representative local taxes. Land and houses constitute tax objects only for the locality in which they are situated, as they have no relations with other localities. They are not transferred from one locality to another, nor are they subject to taxation by any other locality. Taxes on these objects are real taxes, and as such, are taxes only for the locality in which the objects of taxation are situated. There are no other objects which are capable of easier taxation by local authorities. As to taxes on transactions, the tax on immovables may be levied by the locality in which they are situated. The tax on transactions in immovables come next to taxes on land and houses in the ease with which it may be assessed by local authorities. True, immovables may be bought or sold by persons in other localities, but inasmuch as the immovables transaction tax is regarded as a real tax, and, further, as the location of tax objects is given primary consideration, it follows that the objects of this tax may be considered as belonging to a single locality. Business is also easy of local taxation and comes next to land and houses in this respect. This is especially so in the case of a business having its office or headquarters in a single locality. And it should be noted that the great majority of business establishments have their offices in single localities. On the other hand, some business firms have headquarters, branches and plants scattered throughout many localities. In such cases, it will be a difficult task to apportion the whole profit

among the different localities. I am convinced that a fair apportionment can be made if the whole profit is distributed among the different localities concerned, according to the degrees of importance possessed by the personal and real elements of each locality to the whole profit. Thus, business has a natural suitability for local taxation in the great majority of cases; in a small number of other cases local taxation is made possible through some artificial means. Of taxes on consumption, those imposed on objects of use such as vehicles, horses, oxen, dogs and billiard tables are easy of administration by local authorities. Such taxes may be levied only by the locality in which the objects are used, because they have no relations with other localities. This is especially so of billiard tables, which are fixed in their location. Dogs may be somewhat different inasmuch as they are liable to go astray into other localities. Horses, oxen and vehicles also may be transferred to other localities, and thus may come into relations with such localities. But this is rather exceptional and negligible; the majority of them remain where they are used and may, therefore, be taxed therein. Of various vehicles, the automobile may be transferred to a considerable distance, and its taxation by a single locality may give rise to the injustice of certain people paying the tax in the locality where the rate is the lowest, while the automobile is really used in some other locality or localities. Thus the tax on the automobile is difficult of local assessment and therefore is unsuitable as a local tax. The automobile tax would be more properly made a national tax. Thus, taxes on things to be used differ considerably as regards the degrees of suitability for local administration. We have seen that the taxes on land, houses and other fixed objects of use best possess this requirement, and that the taxes on business and many objects of use are somewhat imperfect in this respect, but are still tolerable.

(B) Indispensable conditions for special local taxes. — We shall now take up conditions which are indispensable for special local taxes but not for additional charges on

State taxes. These are conditions under which local authorities can reach tax objects and compute and assess their tax bases. Local organs are far inferior to the State organ in respect to power, range of vision, and fairness of attitude. They cannot possibly be on the same level with the State organ regarding these points. There are conditions under which local organs can levy and collect taxes, if they are surtaxes instead of special local taxes. True, some of the taxes are so simple that they can be levied and collected by local organs as efficiently as by the State organ. In other words, those taxes which can be administered simply by local organs are made special local taxes, while those which are difficult of administration are made surtaxes. There are the following two conditions.

(a) The easiness of reaching the tax objects. — This is the first condition. When tax objects are open to view, as in the case of land, houses and businesses with fixed establishments, they may be easily reached even by local organs. On the other hand, such tax objects as movable capital, especially when unregistered, income and property are difficult to reach. Their real condition cannot be known without making investigation into the economic conditions of individuals, and to do this a strong power is necessary. Moreover, a range of vision extending over the entire nation is necessary in order to have insight into the real conditions of such tax objects. Only the State is capable of fulfilling such requirements as it alone can make use of coercive power in case of necessity or spread a net of investigation all over the country. The State maintains a large staff of experts for reaching tax objects. Local organs lack adequate power; their range of vision is narrow; and their technical power in regard to tax administration is very limited. It is natural, therefore, that they cannot reach tax objects as easily as the State organ can. Of various local organs, agricultural villages have an advantage in that they are in a position to know the economic condition of village taxpayers. But this advantage is only local. It is necessary

at present for a local organ to know a taxpayer's economic connections all over the country instead of in a given locality only, in order to reach his tax objects in their entirety. But municipal organs are still worse off in this respect, for in addition to the shortcoming which is common to all local organs, they also lack knowledge of individual taxpayers within their own limited areas. We may, therefore, conclude that taxes suited for local administration are those which are levied on tangible and external objects such as land, houses and business. Vehicles, horses, oxen and dogs are also suitable objects for local taxation. It goes without saying that local organs may levy additional charges on the taxes fixed by the State, such as those on income, property and movable capital.

(b) The easiness of assessing tax bases. — In order that a given tax may be administered to the satisfaction of taxpayers, it is necessary that the assessment of tax bases be made fairly and appropriately and that consequently taxpayers have confidence in such assessment. Now the State is more efficient, and its assessment is fairer than in the case with local organs, which are often handicapped by partisan strife and class struggle within their narrow limits, thereby making the assessment of local taxes often unfair. It often happens that the opposition party is oppressed by the government party through the unfair imposition of taxes. For this reason, the State will be more suited and fairer than local organs, and it will in otherways be more satisfactory in dealing with the administration of taxes requiring a high degree of technique, as in the assessment of property in the case of the property and inheritance taxes; of rents in the case of the taxes on land and houses; and of net profit in the case of the business profit tax. It may be said that the State rather than local organs should administer taxes, if the two can equally well bring about the same result, for the reason that taxpayers place greater confidence in the State. Thus the taxes on land, houses and business can be more satisfactorily levied by local



organs as additional charges on State taxes rather than as special local taxes. These three taxes may be made special local taxes from the consideration of the conditions given in (a), but the reasons just given point to the advisability of making them surtaxes. True, if the tax on land is levied according to the areas of different pieces of land instead of their values or rents, it will be comparatively easy for even local bodies to assess them and the tax may be made a special local tax. The same contention may be made regarding objects of use, on each of which may be levied a tax of a definite amount or a simple graded classified tax. The house tax and the business tax may be made special local taxes, if they are based on some external indication. Some regard the property tax as essentially a local tax or as a tax suited for local administration. This may have been true in olden times when property was localized, simple in kind and its assessment easy. But as property at present is scattered, complex in kind and difficult of assessment, it will be impossible for local organs to reach it satisfactorily. Inasmuch as its assessment is difficult if not impossible, a special local tax is unsuited for property.

(2) *Relative conditions.*

(A) Desirable conditions for local taxes. (These conditions are of no special importance for national taxes; they are, however, desirable as regards local taxes, though they are not strictly necessary even for them).

(a) Tax objects are of such a nature as to receive special benefits from the locality in which they are situated. Not all local taxes, however, are based on the benefit theory. There are, and should be, some local taxes which are based purely on the ability theory. But there should be local taxes which embody in a large measure the benefit theory and which are at the same time harmonious with the ability theory. Such are taxes on land, houses and business. Of course, all this does not mean that the State is unqualified to tax these objects. On the contrary, the State may tax them, but these objects are not so well suited for national

taxation as they are for local taxation. It may be said that such taxes are entrusted, as it were, to local bodies because they are in harmony with the benefit theory and are otherwise suited for local taxation. The tax on vehicles is also suited for taxation by local bodies because of the above reason.

(b) The continuous and inseparable relations of tax-objects to localities. — I have so far pointed out that the objects receiving special benefits from a locality must preferably be taxed by that locality. But if their relations with a locality are continuous and inseparable, they will be all the more suited for local taxation. The taxes on land and houses are examples. The tax on business may also be placed in the same category. Both land and houses are inseparable from the locality in which they are situated, and their relations with the locality are maintained permanently. For this reason, they will have to bear all necessary sacrifices for the sake of that community. They will have to shoulder the financial burden of the locality, for instance, however heavy it may be. Such objects are, therefore, suited for local taxation. The same contention may be made regarding business, which, however, is movable and thus liable to be shifted to some other locality in case the financial burden of its own locality is too great for it. The possibility of such shifting is greater as regards vehicles, the automobile in particular. Their relations with the locality being temporary and separable, they do not have the conditions under consideration.

(c) When tax objects are likely to cause trouble to the locality where they are located. — An object which is liable to incur expenditure, or otherwise cause trouble to a locality, should be taxed by a local organ. Local communities must regulate such things as dogs, vehicles, amusements, etc.

(B) Conditions desirable for local taxation but not for national taxation.

(a) When the revenue from taxes is subject to the least possible variations in amount. — In State finance, expenditure

is usually on the continuous increase, and this requires that sources of revenue must show natural increases. While such sources are liable to show decreases during times of adversity, it is comparatively easy for the State to issue loans in order to make up the financial deficit under such circumstances. Thus, it is preferable for the State to have taxes having a tendency to show natural increases during normal times, subject, however, to natural decreases during adverse periods. For the State, taxes yielding a fixed amount of revenue are not desirable. All this, however, is not true of local bodies. It goes without saying that local bodies, too, would like to have sources of revenue having a tendency to show natural increases, especially when their expenditure tends to expand; but their expenditure, unlike that of the State, is not necessarily always on the increase. Even when they are in need of such natural increase in revenue, they will have much difficulty in issuing loans to make up their deficits resulting from natural decreases in tax revenue. For this reason, local organs attach importance to those taxes whose revenue is fixed and subject to the least possible variation. Thus, the tax on land and the tax on houses are more suitable for local taxation than for national taxation, because the revenue thus derived is subject to the least variation, as such tax bases have been fixed for many years. On the other hand, the taxes on income and consumption are subject to great variations, and though they may prove advantageous as local taxes at times, are liable to cause much trouble to local bodies at other times. The fact that the revenue from the land tax is fixed is advantageous to public finance during a period of depression, but at the same time it will prove an unbearable burden for the people who have to pay it.

(b) Taxes capable of yielding small amounts of revenue are desirable for local taxation. — Taxes yielding negligible amounts of revenue are not desirable for any community, and especially they are not desirable for the State. It would be better to entrust such taxes to local bodies. It is True that local bodies would also like to have taxes capable of

yielding as large a revenue as possible, but since they are not in a position to complain about the size of revenue, they must be content with the taxes available. Thus, taxes yielding revenue of small amounts are suited to local bodies rather than to the State. For them such taxes are not without value, for they yield some revenue, small though it may be.

(c) Tax objects varying considerably in different localities. — If tax objects are the same all over the country, they may be taxed either by the State or by local bodies. But should they differ in different localities, there will be the possibility of some injustice arising from their taxation in a uniform manner by the single organ of the State. Of course, I do not argue that no national tax should be levied on such tax objects, for it is quite possible so to arrange the national taxes on such objects that justice will be assured, this desirable end being achieved chiefly by considering the various circumstances in different localities. But it will be more appropriate to allow local bodies to tax these objects and make use of them to their own advantage. Take, for instance, the domicile tax. The conditions of domicile in cities differ from those in rural districts and those in different cities and villages differ from one another. The domicile tax, therefore, should be made a local tax and levied by each locality according to its own special conditions.

(d) When tax objects are found only in a locality. — If a certain tax object is found all over the country, instead of being limited to a locality, it may undoubtedly be taxed either by the State or by local bodies, without giving rise to any injustice. However, in the case of a tax object which exists only in a certain locality, it will be a very convenient and useful source of revenue for that locality. Such an object should, indeed, be taxed by a locality; it is perfectly suited to local taxation. Of course, I do not mean by this that the State cannot tax such an object, or that it should be taxed solely by the locality in which it is situated.

On the contrary, the State may tax any object within its boundaries if necessary. But if such an object is taxed by the State, there will be an injustice over the distribution of tax burden between that locality and others. Thus, it is better that the State should refrain from taxing such an object, which may best be taxed as a miscellaneous local tax object. Examples of such a tax may be found in the sled tax and the cormorant tax, etc.

## 2. THE SUITABILITY OF VARIOUS TAXES AS LOCAL TAXATION

I have given conditions for local taxation. I shall now take up various taxes in order to see if they are suitable as local taxation.

(1) The income tax and the household tax. — There is no doubt that these two taxes suit national taxation, but it is debatable whether they suit local taxation. These taxes are based solely upon the ability principle and do not embody the benefit principle. They are unsuitable as taxes which are to be levied according to the benefits received in the locality in which their tax objects are located. But there are arguments in favour of including in local taxation not only taxes based on the benefit principle but those based on the ability principle, especially personal taxes. In Japan the additional charges on the income tax and the household tax have been levied as such taxes. On the other hand, there are several difficulties involved in their imposition by local bodies. One's income may come from not only the locality in which one lives but also from other localities, and such income will be known to the State but not to local bodies. Under the existing complicated economic system, only the State is capable of reaching the total income or property of individuals and local bodies lack sufficient tax technique for the administration of the income tax with satisfaction. Not only they are unable to reach the income which individuals residing therein derive from other localities.

but they will also have a considerable difficulty in making investigations into incomes derived within their own localities, if they are to investigate the incomes of all, including those of the comparatively poor. Furthermore, it is no easy task to levy additional charges on the State tax by making use of the investigations already made by the State. In the first place, it will be a difficult task to apportion such additional charges among various localities. Such apportionment made in the face of such difficulty may give rise to injustice. Secondly, there may be evasion resulting from the very defects of the system. As a method of solution of all these difficulties, I suggest that the income tax should be administered concentratively by the State and that part of the proceeds therefrom should be apportioned among local bodies as State grants.

(2) The property tax. — This tax having developed as a local tax in the United States, Switzerland and elsewhere, it has been wrongly supposed to be suitable for local taxation. It could be a local tax and administered by local bodies during former times when men's property was exclusively located in single localities, and when the classifications of property were simple and its assessment was made as a matter of form. But now men's property extends not only throughout the whole country but even into other countries, and there are many kinds of property, consisting of both tangible and intangible objects. Moreover, property is subject to a freer shifting of location, and its value is subject to frequent variations. In consequence, its assessment has become very difficult. Under such circumstances, it is impossible for local bodies to reach and assess all the properties of individual taxpayers. In other words, the property tax is no longer suitable for handling by local revenue officials. Even supposing the officials of some localities are able to overcome the difficulties indicated and administer the property tax properly within their own jurisdictions, it will be difficult to distribute the tax among different localities. Our obvious conclusion is that the

property tax is unsuitable for local administration. Because of this difficulty of apportionment, the system of levying an additional local charge on the State tax will not be operated successfully. If the revenue from the property tax is necessary for local finance, the method I have suggested should be adopted. The State should increase the property tax by the required amount as an additional local charge to be distributed as grants among the different localities. As real taxes for localities, it will be better for them to depend on the taxes on land, houses and business rather than on the property tax. In Germany the property tax is administered by the State only.

(3) The inheritance tax. — This tax resembles the property tax and is suitable for national taxation but not for local taxation. Local officials are unable to administer it because of technical difficulties. As in the case of the property tax, the system of levying additional local charges on the State inheritance tax will not be satisfactory because of the difficulty of apportionment among different localities.

(4) The taxes on land and houses. — Generally speaking, taxes on products are said to be suitable as local taxation, but this is especially the case in regard to taxes on land and houses. First, such taxes are easy of local distribution; second, since their objects have external signs, it is easy for the revenue officials to reach them; third, they are suited as taxes embodying the benefit theory in local taxation. Their only defect lies in the difficulty that local officials find in making the assessment of their tax objects. Local bodies may be said to be inferior to the State in respect to tax technique and an attitude of fairness, although there is reason to believe that a proper training of revenue officials may overcome such a difficulty. It may be proposed, therefore, that the taxes on land and houses be reached and assessed and otherwise administered by the State, and that local organs then levy additional charges thereon. This system of imposing additional local charges on State taxes is adopted by the taxes on immovables and business in

German localities. France also has a similar system. One might propose in this connection the system that I have suggested above of making grants to local bodies by the State, but in this particular case there is no need of such a system, since there is no difficulty of local apportionment involved in the taxes.

(5) The business tax. — This tax is also regarded as suitable for local taxation. First, its object has an economic relationship with the locality in which it is located; second, its object is easy of reach by revenue officials because of its external signs; in the great majority of cases, local distribution is naturally easy, while in a few cases it is possible by some artificial means. Thus, it may be made a local tax. However, if net profit is to be taken as the tax basis, the task of reaching and assessing such net profit will become somewhat difficult. In carrying out such a task, the State will be more skilled, fairer and more reliable, than local bodies; and some may therefore favour the imposition of additional local charges on the tax arranged and assessed by the State. One may also propose the method whereby the State makes grants to local bodies in amounts equal to the additional local charges on the State tax. But such a round-about procedure is unnecessary because the tax object possess the possibility of local distribution within itself.

(6) The capital interest tax. — This tax is unsuitable as local taxation. First, it is difficult of local distribution; second, it is difficult to reach its tax object as it is lacking in external signs, while the powers of the State are necessary for the investigation involved, and the technique of the State tax-organ is necessary for the administration of this tax; third, it has a very unimportant economic relationship with the locality concerned; fourth, its administration by local bodies will result in the shifting of the tax object to the locality where the tax rate is the lowest. Nor is the imposition of additional local charges on the State tax possible because of the difficulty of local distribution involved. If the revenue from this tax is to be given to local bodies, it



must be given in the form of grants by the State as suggested in the previous cases.

(7) The tax on transfer of immovables. — This tax should be administered according to the taxes on land and houses. We have already pointed out that taxes on land and houses are easy of local distribution; that these tax objects have close economic relations with the locality in which they are situated; that it is easy to reach them because of their external signs; and that for these reasons these tax objects are suited for local taxation. However, where a State tax is already levied on these objects, local special taxes on the same objects will amount to additional charges on the State tax.

(8) The tax on transactions in movables. — This tax is unsuitable as local taxation. Objects taxed may have relations with the general transactions throughout the whole country and for this reason they will be difficult of local distribution. Moreover, since they are lacking in external signs, it will require both considerable power and considerable skill in order to reach them. They are suitable for national taxation but not for local taxation.

(9) Taxes on use. — Generally speaking, the objects of taxes on use are easy of local distribution. The majority of them (at least those selected for these taxes) have external signs and, from the viewpoint of technique, it is easy enough for local organs to reach them. Moreover, they have economic or administrative relations with the locality in which they are situated. The fact that each locality has its own special circumstances regarding these objects makes them all the more suited for local taxation. Moreover, in actuality these taxes will be special local taxes. One exception may be found in the case of the tax on automobiles, which should be taxed by the State, as these tax objects possess in a great degree possibilities of movability.

(10) Ordinary consumption taxes. — As these taxes require a very high degree of tax technique, and at the same time are difficult of local distribution, they should be

made national taxes instead of local taxes. It is natural that customs duties should be administered by the State because these are matters affecting a nation's relations with other nations. The taxes on amusements and recreations are somewhat easy of local distribution, and those having relations with morals should, in some localities at any rate, be administered by local bodies. The French *octroi* are, to a considerable degree, easy of local distribution and are not unsuitable for local taxation. However, the tax itself is not a good one. It falls heavily on the poor, is unjust and prevents smoothness of transaction. Moreover, it has the defect of involving an excessive expense for its collection.

### CONCLUSION

To summarize: The State may make all taxes national instead of local, in spite of certain difficulties that would thereby encountered. Nevertheless, there are some taxes that would best be entrusted to local bodies instead of being administered by the State. The sphere in which taxes are suited for local administration is much smaller than that for taxes suited for national administration, and there are a number of indispensable conditions for local taxes. Many important taxes cannot be made local taxes because they lack the required conditions. Some of the conditions are permissible for national taxes but are desirable for local taxes, while others are not desirable for national taxes but are desirable for local taxes. It is necessary to clarify such relations and to differentiate between suitable national and local taxes in order to bring about the desired adjustment and reform of the tax system. I have reached the conclusion that the following taxes are suitable for local taxation: the land tax, the tax on houses, the business tax, the tax on the transfer of immovables, taxes on use, a small number of consumption taxes, and other miscellaneous taxes.

MASAO KAMBE